

Report of: Executive Member for Finance and Performance

Meeting of:	Date	Agenda item	Ward(s)
Executive	18 June 2015		

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SUBJECT: Procurement Strategy for Contracts for the Supply of Natural Gas and Electricity

1. Synopsis

- 1.1 This report seeks pre-tender approval for the procurement strategy in respect to the Supply of Natural Gas and Electricity (both large 100KW and smaller 'Sub 100KW' sites) in accordance with Rule 2.5 of the Council's Procurement Rules.
- 1.2 The Council needs to procure the supplies of Natural Gas and Electricity for its own and its external clients property portfolios. Such sites include, but are not limited to housing, public buildings, libraries and parks.

2. Recommendations

- 2.1 To approve the procurement strategy for the Supply of Natural Gas and Electricity as outlined in paragraph 3.7 below.
- 2.2 To agree to delegate the key decision of the award of the contracts to the Corporate Director of Environment and Regeneration, in consultation with the Executive Member for Finance and Performance.

3. Background

3.1 Nature of Service/Estimated Value

- 3.1.1 For the last eight years the Council has procured and managed the supply of Natural Gas and Electricity through framework agreements, enabling the Council the flexibility to fix the duration of contracts and the volume of gas and electricity purchases, based on market conditions.

- 3.1.2 The current purchasing strategy is based on flexible, aggregated (with external clients), risk-managed procurement, purchasing tranches of gas and power on dips in the market and against set trigger prices to ensure budget certainty. All gas and electricity must be purchased in advance in order to prevent gas and electricity suppliers imposing punitive default prices. A flexible strategy of buying over a four year period, with some purchases made near to delivery and some further away, helps to mitigate any sharp increases in market prices.
- 3.1.3 The estimated annual value of the contracts is £8.5 million and for the four year agreement proposed for 01/04/2016 to 31/03/2020, this will amount to around £34m. The overall spend is split approximately 75% Council and 25% external clients, meaning £25.5m Council spend and £8.5 million external client spend over the contract period.
- 3.1.4 The tendering process for gas and electricity supplies for 2015/16 produced a cost reduction of around 5-10% compared to the previous year (assuming the same level of energy consumption) due to lower prices being obtained. Stakeholders have been advised to revise budgets to reflect this.
- 3.1.5 Central Government and the Department of Energy and Climate Change (DECC) along with other organisations procuring in the energy sector recognise and have highlighted the benefits of a flexible purchasing strategy that provides mitigation against the extreme volatility of energy prices.
- 3.1.6 The proposed procurement strategy provides the best opportunity for the Council to access dips in the market and to maximise savings in a falling market, and mitigate against costs in a rising market.
- 3.1.7 Historically, price benchmarking has proven very difficult due to commercial confidentiality. Price benchmarking against the DECC quarterly statistics for industrial and commercial contracts, and gas and electricity prices obtained from another Council using a Public Buying Organisation (PBO), have demonstrated that prices obtained via Islington's current procurement strategy are at least comparable and in some cases around 2%-3% lower, although this cannot be a direct comparison.
- 3.1.8 PBO's offer an energy buying service from an existing framework where they purchase the gas and electricity from their preferred suppliers using their purchasing strategy (this is also a flexible, aggregated and risk-managed procurement). All contract management functions remain with the Council/client. The cost of using this energy purchasing service would be approximately £110,000 per year (£440,000 over the 4 year duration of the contract) based on the fee structure provided by Crown Commercial Services (CCS)

3.2 **Timetable**

- 3.2.1 Contracts need to be in place at least three months before current contracts expire on 31/03/2016. This is to accommodate a reasonable buying window before the contract start dates to monitor prices and decide on the term of the flexible contracts.
- 3.2.2 It will be necessary to consult with Leaseholders and to seek dispensation from the First Tier Tribunal under Section 20 of the Landlord and Tenant Act 1985. The Home Ownership Team and Legal Services have been consulted.
- 3.2.3 The timetable for putting contracts in place is as follows:

Begin Leaseholder consultation – June 2015
Invitation to Tender (ITT) – July 2015
ITT Evaluation – Sept/Oct 2015

Award contracts/Standstill Period – Nov 15

A procurement project plan has been produced in consultation with Strategic Procurement.

3.3 **Options appraisal**

3.3.1 There are two main options that have been considered to procure the supply of both Natural Gas and Electricity:

Option A - to continue to procure the supply in-house using the flexible purchasing strategy currently in place or;

Option B – to use a central buying organisation (CBO) such as Crown Commercial Services or Laser to procure on behalf of the Council

By selecting Option A, purchasing in-house, the energy purchasing fees are avoided and the Council can use its own bespoke purchasing strategy. This option is therefore recommended.

3.3.2 The preferred Procurement route is Open Procedure via advertisement in Official Journal of the European Union (OJEU). The contract will be split into three separate lots. Successful suppliers will be awarded all lots, two lots or a single lot depending on their tenderer submission.

3.3.3 The Council purchases for several external organisations, including colleges, academies and local schools. Through these collaborative arrangements, economies of scale are increased making our portfolio more attractive to suppliers. Income to the Council is also received for providing this service to these external organisations.

3.3.4 The volumes we currently purchase allow access to the wholesale gas and electricity markets and as we have detailed data on all of the sites we purchase for, we can make more accurate purchases in terms of volume required either monthly, seasonally or annually.

3.4 **Key Considerations**

3.4.1 An effective strategy to procure the supply of both Natural Gas, and 100KW and Sub 100KW Electricity will have a direct social benefit on the amount residents and leaseholders pay in their rent/leaseholder charges.

3.4.2 A requirement for the payment of LLW will not be appropriate for these contracts since they are contracts for supplies that are subject to the Public Contracts Regulations 2015 and will be established with advertisement in the Official Journal of the European Union.

3.4.3 By competitively tendering on the fixed price element of the end delivered price and then purchasing the commodity (gas and power) from the winning gas/electricity supplier on the open commodities market as part of a flexible, aggregated procurement strategy, the Council should have access to the most advantageous prices available at any given time and can buy volume strategically (monthly, seasonally, annually over several separate years).

3.4.4 Within the tender, suppliers will be required to agree to the Council's Specification of Requirements which details specific terms and conditions we require to improve the management of the contract and to provide economies such as paperless billing to prevent waste, payment by direct debit to ensure security of supply/reduce finance resources required, dispute management criteria and provision of

market intelligence to assist with the general purchasing strategy.

3.4.5 As the procurement methodology is that recommend by DECC we are adhering to best practice principles, as well as purchasing green electricity where appropriate as per the Green Procurement Code.

3.4.6 There are no TUPE, Pensions and Staffing implications

3.5 **Evaluation**

3.5.1 The tender will be conducted in one stage, known as the Open Procedure as the tender is 'open' to all organisations who express interest in the tender. The Open Procedure includes minimum requirements which the organisation must achieve before their evaluation award criteria is considered.

3.5.2 Evaluation will be based on 100% price as we are procuring commodities.

3.5.3 Evaluation will be based on prices submitted by suppliers for fixed/pass through costs. The majority of pass through costs are related to Central Government environmental levies or system charges raised by the National Grid. The remainder of the fixed costs are made up of the supplier's margin, meaning the supplier with the lowest margin for each lot will represent the cheapest price.

3.5.4 Suppliers must agree to enter into the Councils mandatory requirements, the Council will then agree to enter into the supplier's standard terms of business for supply.

3.6 **Business Risks**

3.6.1 Due to the extreme volatility of energy markets, the larger the forward buying window, the greater opportunity to secure the best price for the supply. Therefore contracts will need to be approved and agreed by December 2015 to allow for a sufficient forward buying window.

3.6.2 Housing is the largest service user within the existing portfolio and in order to comply with Section 20 of the Landlord & Tenant Act 1985, Leaseholder Services will need to seek dispensation from First-Tier Tribunal (formerly the Leaseholder Valuation Tribunal). As we intend to enter into contracts in excess of 12 months and are unable to provide detailed costs for all years due to the nature of the procurement (flexibly bought throughout the contract period) dispensation will need to be sought. Dispensation has been sought and awarded in previous years. If it is not, Housing Services will only be allowed to charge Leaseholders £100 per year for utility costs, rather than the actual cost of providing heating/hot water/landlords supplies

3.6.3 The Employment Relations Act 1999 (Blacklist) Regulations 2010 explicitly prohibit the compilation, use, sale or supply of blacklists containing details of trade union members and their activities. Following a motion to full Council on 26 March 2013, all tenderers will be required to sign the Council's anti-blacklisting declaration. Where an organisation is unable to declare that they have never blacklisted, they will be required to evidence that they have 'self-cleansed'. The Council will not award a contract to organisations found guilty of blacklisting unless they have demonstrated 'self-cleansing' and taken adequate measures to remedy past actions and prevent re-occurrences. Within the tender, suppliers will be required to agree to the Council's Specification of Requirements which details specific terms and conditions we require to improve the management of the contract and to provide economies such as paperless billing to prevent waste, payment by direct debit to ensure security of supply/reduce finance resources required, dispute management criteria and provision of market intelligence to assist with the general purchasing strategy.

3.7 The following relevant information is required to be specifically approved by the Executive in accordance with rule 2.6 of the Procurement Rules:

Relevant information	Information/section in report
1 Nature of the service	Supply of Natural Gas and Electricity
2 Estimated value	The total estimated value per year is £8.5m, split approximately 75% Council and 25% external clients. The agreement is proposed to run for a period of 4 years.
3 Timetable	Award decision likely in November 2015, with contract start in April 2016. See paragraph 3.2
4 Options appraisal for tender procedure including consideration of collaboration opportunities	Continue to procure supply in-house using flexible purchasing strategy. Procurement route is Open Procedure. See paragraph 3.3
5 Consideration of: Social benefit clauses; London Living Wage; Best value; TUPE, pensions and other staffing implications	See paragraph 3.4 - A requirement for the payment of LLW will not be appropriate.
6 Evaluation criteria	100% on price as this is a commodity
7 Any business risks associated with entering the contract	Main risk is with respect to Housing Services consulting with leaseholders on dispensation .
8 Any other relevant financial, legal or other considerations.	None

4. Implications

4.1 Financial implications:

This report seeks approval for the Procurement Strategy for the supply of electricity and gas for a four year period between 2016-20. It is estimated that the energy cost during this period will average £8.5m per annum with around £6.375m met from Council budgets and £2.125m received from external clients.

The report recommends procurement option A which continues the current arrangements of using an in-house procurement strategy over the use of a Public Buying Organisation (PBO). Based upon past performance and some limited comparative data, option A has a greater financial benefit for the Council, however this is no indication of best market performance nor future comparative performance of the two procurement options.

4.2 **Legal Implications:**

The Council has power to procure the supplies of Natural Gas and Electricity for its own use under section 111 of the Local Government Act 1972 which enables the council to carry out any activity that is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions. The council has power to procure these supplies on behalf of other organisations under section 1 of the Localism Act 2011. The council may enter into contracts for such supplies under section 1 of the Local Government (Contracts) Act 1997. The Executive may provide Corporate Directors with responsibility to award contracts with a value over £500,000 (Procurement Rule 14.2).

The estimated value of the proposed contracts is above the threshold for application of the Public Contracts Regulations 2015 (currently £172,514). Therefore these contracts must be procured with advertisement in the Official Journal of the European Union and in full compliance with the Regulations as proposed in the report.

On completion of the procurement process the contracts may be awarded to the highest scoring tenderers. In deciding whether to appoint the selected contractors the Corporate Director of Environment and Regeneration should be satisfied as to the competence of the chosen tenderers and that the tender prices represents value for money for the Council.

4.3 **Environmental Implications:**

The major environmental implication for the supply of electricity and gas is the type of electricity purchased, as electricity generation via fossil fuels is the largest single source of CO₂ emissions in the UK. The Council will therefore seek to purchase “green” electricity (i.e. generated by renewables) when it is revenue neutral.

4.4 **Resident Impact Assessment:**

The Council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

By purchasing utilities as effectively as possible, we are reducing the financial burden on tenants and leaseholders who are charged for landlords services in respect of communal lighting, lifts, door entry, heating and hot water (where appropriate).

5. Conclusion and reasons for recommendations

- 5.1 The current contracts for the supply of both Natural Gas and 100KW &sub 100KW Electricity expire on 31/03/2016. In order to purchase utilities after this date a procurement strategy is required to allow procurement to commence.
- 5.2 By adopting the existing method of procurement, which is based on an aggregated flexible, risk managed strategy, we will have continuity of service and security of future supply without incurring additional cost of using a Public Buying Organisation.
- 5.3 The proposed procurement strategy allows for opportunities in the market to be realised, whilst giving a level of budget certainty through the setting of price trigger points and the ability to sell back any trades made.
- 5.4 The strategy provided considerable savings for 2015/16 by allowing the Council to access lower prices during a period of falling prices, due to the nature of the flexible contracts the Council had in place.
- 5.5 By entering into contracts for the supply of both Natural Gas and Electricity for a four year period, we will be able to maximise the benefits of a flexible procurement strategy.

Appendices - none

Background papers: none

Final report clearance:

Signed by:



29.5.15

Executive Member for Finance and Performance

Date

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Head of Democratic Services

Date

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